MEMORANDUM AND ANALYSIS

This Memorandum and Analysis is in support of the plan to create a combined health care network involving UMC, the Jewish System, Flaget Healthcare, Inc. ("Flaget") and St. Joseph Health System, Inc. ("St. Joseph System") to be operated by the Network Entity (the "Combination").

Executive Summary

The proposed Combination has generated a high degree of public interest and media coverage. This Memorandum provides an opportunity to clarify the facts and the terms of the proposed Combination.

• The Combination will bring about the investment of $800 million in the state-wide network ("KSN") over the next five years. This investment will include $200 million in funding at the Academic Medical Center for the development of new clinical programs and the relocation of existing clinical programs to the Academic Medical Center. This funding will be agreed to by the Sponsors by closing. The Combination will also create a statewide physician network of over 3,000 physicians, operating from more than 90 health care facilities.

• Neither the University of Louisville nor physicians associated with its School of Medicine will lose independence. Neither the University nor the School of Medicine will be bound by the Ethical Religious Directives of the Roman Catholic Church or other religious directives and teachings (collectively "Faith Based Principles" or "FBPs"). Healthcare decisions will continue to be made solely by the patient and his or her physician.

• UMC will not become "a Catholic hospital" subject to the FBPs. Instead, UMC will continue to operate as a secular teaching hospital not bound by the FBPs. UMC has agreed, *by contract,* not to perform certain procedures at UMC's facilities — notably, elective abortions and euthanasia (both of which are already prohibited by state law from being performed on state property); tubal ligations; and the dispensing of certain drugs for the sole use as contraceptives. However, there is no restriction on the ability to perform these procedures elsewhere or the dispensing of these drugs for other medical reasons or at other locations. Should additional restrictions be proposed in the future as a result of changes in the ERDs, the Combination may be unwound.

• The Combination will not change how the Hospital or the medical staff deals with "end of life" patient issues at the Hospital.

• There will be no compromise of women's reproductive health options.

• The quality of care afforded to indigent patients both in Louisville and throughout the Commonwealth will be enhanced.

• The "establishment clause" of the First Amendment to the United States Constitution will not be violated by the Combination — UMC is not a "state actor", and, even if it was, the

Combination does not endorse religion and there is no "excessive governmental entanglement with religion."

• In the unlikely event that the Combination proves problematic to the University or the Commonwealth due to certain breaches by the parties, the transaction may be unwound, with the result being that the University or an entity designated by the University would own both UMC's current facilities and some or all of the Jewish System's other facilities. The price of such an unwind is fair, affordable and financeable. Either the University or the Commonwealth may trigger this unwind.

• Failure to approve the Combination will jeopardize the future existence of Louisville's primary teaching hospital and principal provider of indigent and stroke victim care. Without the Combination, UMC will face the future as an undercapitalized hospital without the capacity to make much-needed improvements to its physical plant. It will have no capacity to improve its profitability by attracting enough "private pay patients" to offset the more than $20 million annual shortfall resulting from uncompensated (either by DSH Funding or the QCCT) charity care. As the smallest and weakest competitor in a highly competitive and changing healthcare marketplace, its demise will only be a matter of time.

• Failure to approve the transaction and thereby maintain the Hospital as a competitive teaching hospital will impair the University's ability to attract and retain a high-quality faculty and its capacity to train the Commonwealth's next generation of physicians.

I. Background of the Transaction

The University of Louisville was a private university until 1970, when it entered into the Commonwealth's system of higher education. The University did not have its own hospital at that time. Instead, most of the University's teaching programs were at the old Louisville General Hospital. After the University entered the state system, the Commonwealth decided that the University should have a university hospital. Construction began in 1978, and University of Louisville Hospital was opened in 1983.[1]

When the Hospital was opened, then-Governor Brown issued an executive order to the effect that the University's hospital would be managed and operated for the University by a private, for-profit company (Humana), which at that time was in the hospital business. Humana and its for-profit affiliates and successors operated the Hospital from 1983 to 1996. Those troubled by the notion of a "loss of control" of the Hospital should note that for the first 13 years of the Hospital's existence, a private, for-profit company with a fiduciary responsibility to its stockholders, not to the Commonwealth, operated the Hospital pursuant to agreements with the Commonwealth and the University.

[1] Allusions have been made in the press and elsewhere to the Commonwealth's "investment" in the Hospital. The Hospital was constructed at a cost of $72,000,000, of which $6,000,000 was paid for with federal grants. Since the Commonwealth's initial "investment", UMC has invested approximately $230,811,132 in "non-state" funds in the facilities.

Following the merger of Humana's hospital business with that of Columbia/Hospital Corporation of America's and the decision by Columbia/HCA to relocate its headquarters to Nashville, Tennessee, the Commonwealth negotiated the termination of Humana's operating agreement, with the goal of having local healthcare entities, rather than an out-of-state company, operate and manage the Hospital for the University. Accordingly in 1995, Jewish Hospital Healthcare and Norton Healthcare, Inc. (formerly known as Alliant Health System, Inc.) established and created UMC as a private, non-profit Kentucky corporation. Jewish and Norton acted as UMC's sole incorporators and created UMC to have a vehicle to compete for the opportunity to enter into agreements with the University and the Commonwealth to operate the Hospital, as Humana had in the past.

UMC's Articles of Incorporation set forth purposes similar to that of other non-profit hospitals. According to its Articles of Incorporation, the purposes of UMC are: (1) "[t]o operate and maintain the hospital affiliated with the University of Louisville School of Medicine, and to provide medical care for the people who are in need of those, or related, medical services" and to "provide such other services as are related to the delivery of medical care"; (2) "[t]o carry on educational activities related to rendering care to the sick and injured, or to the promotion of health"; (3) "[t]o promote and carry on scientific research related to the care of the sick and injured"; (4) "[t]o participate, so far as circumstances may warrant, in any activity designed and carried on to promote the general health of the community"; and (5) "[t]o provide, on a nonprofit basis, hospital or health care facilities and services for the care and treatment of persons who are acutely ill or who otherwise require medical care and related services."

In 1996, the University and the Commonwealth awarded UMC the contract to operate the Hospital on behalf of the University pursuant to various agreements between UMC and the University. UMC has managed the hospital since 1996.[2]

The real property upon which the Hospital sits, as well as the buildings and fixtures constructed by the Commonwealth, are owned by the Commonwealth of Kentucky "for the use

---

[2] Specifically, UMC leases and manages the Hospital for the University pursuant to an Affiliation Agreement entered into by the Commonwealth, University, and UMC. "UMC will be responsible for the operations of the Hospital" and, thus, is "entitled to all revenues and liable for due payment of all expenses." (Affiliation Agreement ¶ 11.1.) At the same time, "any surplus will either be reinvested in the operation of the Hospital or distributed to the University for enhancement of its medical school or other Health Sciences Center programs." (*Id.*) While UMC manages the Hospital's day-to-day operations, the Affiliation Agreement provides the general terms governing UMC's management of the Hospital on behalf of the University, including the parties' agreement that: "the Hospital shall serve as the principal adult teaching hospital of University and shall be available for teaching, research and clinical care programs of the University School of Medicine, Dentistry[,] Nursing and Public Health; the parties will use their "Best Efforts to keep the Hospital and its associated programs fully licensed and accredited as needed effectively to conduct its business and programs"; and "no training programs or rotations will operate at the Hospital or any Related Facility without the prior written consent of University." (*Id.* ¶ 5.1.1.) The Affiliation Agreement also addresses the Hospital's medical staff, patients, indigent care, accreditation, continuing medical education and patient education, and other matters as they relate to the University and its faculty and programs. The initial term of the Affiliation Agreement is 15 years, with the possibility of three 5-year renewal periods. (*Id.* ¶ 25.1.) It may be terminated for cause by either party and may be terminated by the University for "academic cause" or loss of accreditation due to certain failures by UMC. (*Id.* ¶ 25.2.) The current Affiliation Agreement has been extended so that it does not terminate prior to the maturity date of UMC's outstanding bond issue.

and benefit of the University of Louisville." That real property is leased by the Commonwealth and the University to UMC "solely for the conduct and operation of an acute-care teaching general hospital and related medical facilities as set forth in the Affiliation Agreement." Pursuant to the UMC Lease, UMC rent payments are made from UMC to the University. (*Id.* ¶ 4.F.)

While the Hospital has been the University's primary adult teaching hospital since it was opened, it is not the only hospital the University uses for teaching purposes. The Hospital itself has only 320 beds currently in operation, which are not enough given the University's various teaching programs. The University's primary pediatric teaching hospital is Kosair Children's Hospital, which is owned and operated by Norton Healthcare, a private healthcare company. Faculty and students from the University's Medical School also provide services at Norton Hospital, Jewish Hospital, the Veterans Administration Hospital, Baptist Hospital East, and Trover Clinic. Other than the Veterans Administration Hospital, each of the other facilities where University faculty and students provide services is owned and operated by a private entity. In every one of those cases, the University of Louisville School of Medicine has an academic affiliation agreement which spells out the terms and conditions of the University's partnership with the entity.

In May 2007, Jewish and Norton withdrew from membership in UMC. Following the withdrawal of Jewish and Norton from UMC in late 2007, UMC amended its Bylaws to adopt a community-based board structure in which: (1) a majority of those present at any of UMC's board or committee meetings must be non-University affiliated members to constitute a quorum; (2) new board members (which previously had been selected by the members) are selected by a nominating committee comprised of current board members, less than a majority of whom are University-affiliated; (3) the total number of University-affiliated board members are limited to a minority of UMC's board; and (4) each committee of UMC's board must have less than a majority of University-affiliated members. UMC has thus ensured the active involvement of non-University affiliated board members and, thus, its own independence from the University. UMC's board of directors, the majority of whom are community-based — not the University — establishes UMC's mission and directs its actions.

This arrangement continues today: UMC is governed by an independent, self-perpetuating board comprised of seventeen voting members, at least nine of whom must be independent of the University of Louisville and no more than eight of whom may be affiliated with the University. Currently, two of the University positions are vacant.

UMC is responsible for its own affairs and its own liabilities. Under the terms of the Academic Affiliation Agreement, UMC is "responsible for the operations of the Hospital and as such shall be entitled to all revenues and liable for due payment of all expenses. Any surplus will either be reinvested in the operation of the Hospital or distributed to the University for the enhancement of its medical school or other Health Sciences Center programs . . . ." *Id.* 11.1. The agreement also provides that UMC "will pay University lease payments as provided in the [UMC] Lease Agreement"[3] and "will bear responsibility for all losses resulting from operation of

[3] The Hospital's and Cancer Center's physical buildings and the real property upon which they sit are owned by the Commonwealth of Kentucky and are leased to UMC. Under the terms of the lease, UMC was obligated to pay

[the Hospital and its related facilities] to the extent such losses are not covered by guarantees of borrowings, financings, surplus distributions, and QCCT funds or other sources . . . ." *Id.* 11.3, 11.2.3.

UMC controls the daily management of the Hospital. UMC and the University maintain separate information technology, marketing, business development, and other departments. The University has no control over UMC's safety procedures, signage, marketing, human resource issues, purchasing, or accounts payable/receivable. UMC is not required to obtain the University's approval before obtaining new capital equipment. Rather, the annual hospital budget is approved by UMC's Board of Directors. UMC and University physicians maintain separate medical records. While UMC works with the University on collaborative efforts, such as space management and strategic issues affecting both entities, UMC does not seek University permission before engaging in management of the Hospital.

All non-physician staff members — nurses, lab technicians, phlebotomists, radiology assistants, human resources, information technology, marketing, and training staff, etc. — are UMC employees. UMC employs approximately 2,837 people who work at the Hospital, and approximately 700 physicians have privileges at the Hospital. UMC has the authority to train, discipline, and fire UMC employees. With respect to the physicians, UMC has the authority to revoke a physician's hospital privileges; UMC does not have to obtain the University's approval to do so. University faculty are not restricted to practice at the Hospital; they can practice at any hospital where they have staff privileges.

II. Reasons for the Combination; Benefits from the Combination

The Combination involves combining the facilities currently operated by UMC, the Jewish System, Flaget, and the St. Joseph System. The St. Joseph and Flaget Hospitals are owned and operated by Kentucky non-profit corporations with local community-based boards of directors, and each has as its sole member Catholic Health Initiatives ("CHI"), a Colorado non-profit corporation. The Flaget and St. Joseph System operate healthcare facilities across Central and Eastern Kentucky with a mission to improve the delivery of healthcare across the Commonwealth. The Jewish System is a joint venture between an affiliate of CHI and Jewish Hospital Healthcare Services, Inc. ("JHHS") which operates certain medical facilities in Louisville, Shelby County, and Bullitt County. The University of Louisville Medical School has had a long affiliation with the Jewish System, beginning 60 years ago when Jewish Hospital moved to a location near the Medical School. A number of Medical School programs are currently located at Jewish Hospital (e.g., solid organ transplant, heart program, sports management, spinal injury, hand program, clinical trials for research initiatives), and the Jewish System has been a long and valued partner of the Medical School. Following the Combination, the Hospital and the James Graham Brown Cancer Center, along with Jewish Hospital, and

---

$416,666.67 per month in rent during the first 5-year term of the lease, $458,333.33 per month during the second 5-year term, and $500,000 per month during the third 5-year term (February 2006 to January 2011). The rent increases for each extended five-year term. *Id.* The lease also provides that UMC "shall not assign, mortgage, pledge or encumber" the lease or sublet the premises without first obtaining the written consent of the Commonwealth and the University.

Frazier Rehab Institute, will serve as the principal adult teaching hospital and primary clinical site of the University of Louisville School of Medicine.

The reasons for the Combination and the benefits that it will bring to Kentucky's citizens are many. They fall into four general categories: (1) responding to the health challenges that face Kentucky; (2) creating a network with the depth and breadth that can successfully face the challenges of the changing healthcare landscape; (3) insuring that the commitment to indigent care can be continued and enhanced in light of the financial pressures placed on the healthcare system; and (4) insuring the survival of the University's teaching and research mission.

(1) Responding to Kentucky's healthcare challenge.

Kentucky's health care challenges have been well-documented. According to data from the Centers for Disease Control and the American Heart Association, Kentucky ranks first in the number of deaths from cancer, first in the prevalence of heart disease, third in the incidence of obesity, and ninth in the number of deaths from heart disease or stroke.

(2) *Depth and Breadth of the Network.*

Nearly half of the Commonwealth is deemed medically underserved, with our citizens unable to access healthcare readily when they need it.

The Combination will bring together academic and community physicians and other healthcare practitioners, creating a medical staff of more than 3,000 physicians across the Commonwealth operating from hospitals, clinics, specialty institutions, home health agencies, and satellite primary care centers with 91 locations. It will integrate medical research, education, technology, and health care services wherever patients receive care. It will enable the network of physicians, using telemedicine and other technologies, to expand access to specialty care to communities that are underserved. And it will result in the immediate capital infusion by CHI of $320 million in support of the system's mission, statewide, $100 million of which will be invested in statewide health services and $200 million of which will be invested in the academic medical center in Louisville. Over the first five years of the Combination, $800 million will be invested in the network, including growth of facilities in rural areas and information technology. In addition to providing greatly increased financial resources, the Combination will permit UMC and its partners to address inequities in health care delivery and provide more health care resources throughout the Commonwealth. It will allow the merged entity to take the world-class research being done at the University of Louisville and make it available to a broader population.

The Combination will also give Flaget and the St. Joseph System the opportunity to connect its clinical mission, which is largely located in medically underserved areas of central and eastern Kentucky, to the full portfolio of medical services it needs to serve its disparate community and will also provide the clinical work force that is essential to its survival. Kentucky had a 2,300 physician shortage as of 2007 and is projected to experience a 3,000 physician shortage by 2020. In a state where the physician work force and clinical work force is as scarce as it is in the Commonwealth and, by extension, as expensive as it is in the Commonwealth, there can be either a duplicative/competitive approach to clinical program

development (which may increase costs) or it may be done in partnership, which allows for economies of scale and the potential for reduced costs . The Combination will allow the St. Joseph System to partner with the University of Louisville School of Medicine, expanding access to scarce primary care specialties while concurrently reducing costs. Moreover, the School of Medicine's enhanced exposure to Flaget, the St. Joseph System, and CHI's other hospitals will create new opportunities to conduct clinical trials.

(3) *Continued Commitment to Indigent Care and Benefits to the Hospital.*

In 2009, the three prospective partners to the Combination provided more than $270 million in indigent care and other charitable benefits to their communities. The Combination ensures that the highest level of service to the indigent population of Kentucky can continue. Ironically, while each partner shares a deeply-held commitment to caring for everyone, regardless of ability to pay, underwriting indigent care separately means that capital reinvestment in facilities — the reinvestment necessary to provide the very indigent care to which the partners are committed — is compromised over time.

When the Combination occurs, the Hospital will see a variety of benefits. Efficiency and cost-savings will increase. There will be additional specialists. There will be additional resources and expertise. The additional specialists and resources mean that fewer patients will have to travel to places like the Cleveland Clinic or the Mayo Clinic.

The Combination will increase access to health care because the healthcare facilities that are being consolidated have more access points than the Hospital does. Plus, this access will be "closer to home", meaning that the patients will be able to access this care without having to come to the downtown facility. This increased access will not just be seen in Jefferson County. The Combination will also increase the quality of care because the new Network Entity will be able to address the health needs of its population much better than any single entity could. UMC and the Cancer Center offer an academic center, a level-one trauma unit, and advanced cancer and stroke care. Jewish and St. Joseph's facilities both have exceptional cardiac care, ambulatory care, and home healthcare services, which are relatively lacking at UMC.

Care will be available post-Combination which is not within the Hospital's reach without the Combination. For example, thermoplasty therapy is a heat treatment for severe asthma. In a system the size of KSN, it will make sense to offer thermoplasty treatments because the potential number of patients needing that treatment is sufficiently large. Currently, UMC does not offer that treatment. Other examples include the likely growth and expansion of cancer services (e.g., melanoma, lung cancer, breast cancer), all as part of statewide clinical trials and the clinical care network.

Further, the Combination will substantially improve the University's ability to obtain NIH grants. One of the five factors the NIH uses in determining which grants to issue includes the "environment," which is the size and reputation of the institution conducting the research and its patient base. The bottom line is that, in the NIH context, the stronger the facility is, the more likely that research dollars will flow to it.

(4) *The University's Teaching Mission*

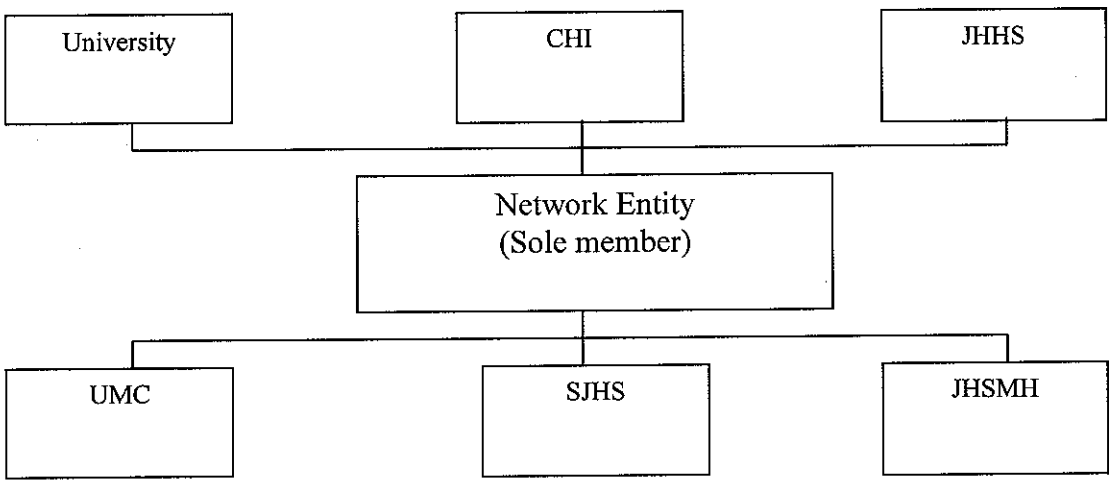
As discussed above, in a state already facing a dire physician shortage, the Combination means increased opportunities to train the next generation of physicians and keep them in the Commonwealth. Through an affiliation agreement with the Network Entity, the School of Medicine will be able to extend its teaching and research programs statewide. The Combination will include a commitment by the Network Entity to invest $200 million within the first three years following Combination to expand the academic medical center in Louisville by expanding existing teaching programs and facilities at the University, including attracting specialists not currently available in Louisville.

UMC is boxed into the Hospital footprint at 545 South Jackson Street. Likewise, the University of Louisville School of Medicine, for many of its programs, is boxed into the Hospital and whatever other piecemeal arrangements it can make through affiliation agreements with other hospitals. The Combination offers a whole new and expanded clinical platform for the School of Medicine's teaching programs and for translational research. The Jewish System, like UMC, needs to increase its size and is locked into its current location. The Jewish System also recognizes that the University of Louisville Medical School needs a robust teaching program to allow the Medical School to continue to recruit the best students, the best residents/fellows, and the best faculty and to create the infrastructure to make sure that the Jewish System (and the rest of the Commonwealth) will have the physicians needed in the future. The Jewish System has converted some of its programs, particularly cardiovascular programs, to an exclusive arrangement with the University where Medical School faculty are performing the procedures because the clinical outcomes are better, the length of stay is shorter, and costs are contained. It believes that the Medical School's knowledge, skill, and expertise is valuable not only to the Jewish System but to the rest of the Commonwealth.

III. Description of the Transaction

The Network Entity, which will be a Kentucky nonprofit corporation exempt from federal income tax, will become the sole member of each of (i) UMC, (ii) Jewish Hospital and St. Mary's Health Care, Inc., and (iii) St. Joseph Health System, Inc. and Flaget Healthcare, Inc. CHI, JHHS, and the University (collectively, the "Sponsors") will become the sole members of the Network Entity and will have the following membership percentage interests: 70% - CHI; 16% - the University; and 14% - JHHS. These percentages were based on an independent valuation of the assets contributed and really only come into play upon any dissolution of the

Network Entity and the distribution of excess cash (as described below). UMC will continue as a Kentucky nonprofit corporation after the Closing.



At closing of the Combination, CHI will contribute $320,000,000 to the net assets of the Network Entity for new, needed working capital and the Network Entity will commit an additional $200,000,000 for investment in expanded medical services during the first 36 months after closing in a plan to benefit the downtown teaching hospital through development, consolidation, and relocation of the School of Medicine's service lines at the Network Entity facilities and customization of information technology unique to the teaching hospital.

Upon obtaining certain financial performance benchmarks, the Network Entity's board of directors will make disbursements to the Sponsors to further their charitable missions, which would be allocated: (i) 10%, to the University for use at its health sciences campus; and (ii) 90%, to the Sponsors based on their respective percentage membership interests in Network Entity.

The Network Entity will continue to pay $11,000,000 (an amount equal to the annual payment paid by UMC to the University to support the University's health sciences campus) as well as continuing approximately $70 million in existing financial arrangements in support of the University's School of Medicine, such as: payment of salary and benefits for approximately 290 medical residents; support of academic department chair/chief of services salaries and benefits; continuation of existing professional service agreements, department support agreements, medical director agreements, and hospital-based and exclusive contract agreements; a new annual commitment of at least $3 million for clinical research and research infrastructure support; lease payments to the University in respect of the Hospital; and support of adult outpatient teaching clinics operated by the University. The $11,000,000 payment, which has been the same for many years, will be increased in future years based upon changes to the Consumer Price Index. JHSMH will transfer the real estate improvements used by the University's Cardiovascular Innovation Institute, valued at approximately $15,000,000, to the University.

UMC Excluded Assets: UMC's interests in certain ventures will be excluded from the KSN transaction, such as UMC's interest in Passport, which is intended to be transferred to the

University (or its designee) prior to the closing of the Combination. UMC's ownership interests in two affiliates of Premier, UMC's current purchasing group organization, will be conveyed to an affiliate of the University which could benefit from becoming a participant in the Premier purchasing group.

Real Estate: Following the Combination, under the New Lease, UMC will not only continue to lease from the Commonwealth of Kentucky and the University land and improvements owned by the Commonwealth, to wit, the James Graham Brown Cancer Center, the primary UMC Hospital building, and the primary Hospital parking garage, but will also lease from the Commonwealth the primary Jewish Hospital building and the Frazier Rehabilitation Center, each of which are also located in downtown Louisville. Additionally, UMC will lease or sublease from JHHS several contiguous properties including the Rudd Heart & Lung Center, the Jewish Hospital Outpatient Care Center, the visitors' parking garage for Jewish Hospital, and the employees' parking garage for Jewish Hospital.

Finally, it is anticipated that the Cardiovascular Innovation Institute building located at 302 E. Muhammad Ali Boulevard will be transferred in fee to the University.

Governance of Network Entity: The Network Entity board of directors will consist of 18 voting members, with ten appointed by CHI (56%) and four appointed by each of the University (22%) and JHHS (22%). CHI will appoint the initial board chairman and the University will appoint the second board chairman, and appointment of subsequent board chairmen will rotate among the Sponsors. No more than two appointees, CHI, and not more than one appointee of the University of CHI and JHHS, may be employed by the Sponsors or their affiliates, assuring a community-based board of directors with a fiduciary duty to the Network Entity.

Affiliation with the Academic Medical Center: A 12-member standing committee of the Network Entity Board (the "Academic Medical Center Committee") will provide input and recommendations to the Network Entity Board on matters related to the "Academic Medical Center."[4] At all times, a majority of the members of the Academic Medical Center Committee will be individuals affiliated with the University, and positions on the Academic Medical Center Committee will be assigned as follows: (i) the University's Executive Vice President for Health Affairs (who will chair this committee, unless he/she designates another committee member to do so); (ii) the Dean of the University's School of Medicine; (iii) five full-time faculty members from the University's School of Medicine (as appointed by the University); (iv) one individual appointed by JHHS; (v) two community physicians on Network Entity's medical staff; (vi) the CEO of Network Entity; and (vii) the CEO of the Academic Medical Center (who will be the only non-voting member of the Academic Medical Center Committee).

The Academic Medical Center Committee will provide input and recommendation to the Network Entity board of directors regarding any action which could materially affect the teaching, clinical, or research mission of the University or would eliminate or significantly reduce existing clinical services or prevent the development of a new clinical service deemed necessary by the University for a complete and competitive academic medical center. Among

[4] The "Academic Medical Center" will consist of the Hospital, James Graham Brown Cancer Center, Frazier Rehab Institute, and Jewish Hospital

the responsibilities of the Academic Medical Center Committee will be to: (i) work with the Network Entity CEO and management team to recommend a capital and operating budget for the Academic Medical Center; (ii) provide input to the Network Entity CEO in the firing, discipline, and job performance evaluation of the CEO and the CFO of the Academic Medical Center; (iii) regularly provide input and recommendations to the Network Entity Board on the strategic plan specific to the Academic Medical Center; and (iv) provide an annual "State of the Academic Medical Center" report to the Network Entity Board.

At the closing of the Combination, the University will enter into a new Academic Affiliation Agreement with the Network Entity, the primary objective of which will be to provide an expanded and more comprehensive hospital campus to serve as the principal adult teaching hospital for the University's School of Medicine and to make the Academic Medical Center available for teaching, research, and clinical care programs at the University's Schools of Dentistry, Nursing, and Public Health. Ultimately, UMC will hold the hospital licenses to operate the entire Academic Medical Center and will be required to do so as set forth in the Academic Affiliation Agreement. The University's School of Medicine will retain sole responsibility for addressing all faculty, residency, fellowship, and student related issues, including the power to employ and dictate the work assignments of its faculty.

The Academic Affiliation Agreement will have an initial term of 25 years and will automatically renew for up to three successive renewal terms of fifteen years each, unless a party provides written notice of intent to terminate at least 12 months prior to the expiration of the then-applicable term. The University will have certain remedies, including a right to terminate the Academic Affiliation Agreement for imminent or actual probation, administrative closure, or loss of accreditation of the Academic Medical Center which results from Network Entity's failure to reasonably support a current training program. Upon termination of the Academic Affiliation Agreement, the University will have the right to purchase the Academic Medical Center from Network Entity an amount equal to: (i) the fair value of the Academic Medical Center at the time of termination, less (ii) the amount of Academic Medical Center's liabilities at the time of termination assumed by the University, less (iii) the fair value of the University's membership interest in Network Entity as of the time of termination. Upon a breach of the Sponsorship Agreement, the Academic Affiliation Agreement, or the New Lease, the expiration of any cure periods, and the failure of any applicable dispute resolution procedures to resolve such breach to the University's satisfaction and the University's failure or refusal to exercise its rights, the University's rights may be exercised by the Commonwealth directly.

IV. Discussion of Policy and Legal Issues Raised in Response to the Planned Combination

A. Women's Reproductive Services and Other Medical Services will be Enhanced by the Combination

Community and media discussions concerning the Combination suggest that some in the community are under the impression that the Combination will result in a substantial change in care at the Hospital. This impression is mistaken.

Following the Combination, the University facilities (including the Hospital and Cancer Center) and the downtown Academic Medical Center will not be bound by FBPs. The parties

have agreed that certain designated procedures will not be performed at the Network Entity's facilities, but there is no restriction on their being performed elsewhere. Neither the University of Louisville, its School of Medicine, nor the Hospital will become Roman Catholic entities. The Hospital will continue to be operated in a manner consistent with academic practices of a secular state teaching hospital.

Three procedures have been subject of a great deal of media ink and public attention: the availability of elective abortions; euthanasia services; and tubal ligations. It is important to understand the status of each of these procedures under current law as well as future practice.

(1) Elective (Direct) Abortions

Elective (Direct) abortions are not *currently* allowed by state law to be performed at the Hospital. The University of Louisville's Medical School training for that procedure does not occur at the Hospital and will not occur at the Hospital following the Combination. The only abortions currently performed at the Hospital are medically-indicated abortions, as distinct from an abortion for pregnancy termination as the sole indication. The occurrence of pregnancy concurrent with carcinoma of the cervix, pregnancy with congestive heart failure or pulmonary hypertension, of which there are zero to three cases per year in Jefferson County, are currently performed at University Hospital and will continue. After the Combination, if a woman presents in the Hospital's Emergency Room and needs an "abortion" to save her life, the decision will continue to be made between the patient and her physician. The number one concern in providing emergency care in such situations is to preserve the life of the mother. Consistent with the CPA, an abortion necessary to cure a serious pathological condition of a pregnant woman is permitted where the treatment cannot be safely postponed.

(2) Euthanasia

Euthanasia is not allowed under Kentucky law, is not currently allowed at the Hospital, and will not be permitted following the Combination. The Hospital currently follows end-of-life directives/living wills that comport with Kentucky law regarding such directives. Currently at the Hospital, nutrition and hydration may be removed, and are removed, from patients with end-of-life directives who have an acute terminal illness[5] and are in a persistent vegetative state. This practice will continue following the Combination.

(3) Contraception and Tubal Ligations

Contraceptive counseling and treatment are currently provided to patients by their doctors. University physicians with staff privileges at the Hospital will continue to be able to provide a full range of contraceptive counseling and write prescriptions for contraceptives.

---

[5] UMC is unable to identify any instance since it has been managing the Hospital where a patient in a persistent vegetative state with an advance directive had his or her hydration and nutrition removed, absent an additional acute illness. The scenario simply does not present itself. It takes a substantial amount of time (at a minimum, 30 days of unchanged vitals) for a patient to be determined to be in a persistent vegetative state. Under those circumstances, patients are transferred from the Hospital (an acute care facility) to a long-term care facility well before any determination that the patient is in a persistent vegetative state and, thus, well before the removal of hydration and nutrition is permitted under Kentucky law absent an acute terminal illness.

Although contraceptives will not be dispensed at the Hospital's pharmacy solely for the purpose of preventing pregnancy, University physicians can continue to write those prescriptions and they can be filled at any other pharmacy.

There will be no change in the Hospital's current policies and procedures concerning emergency contraception after rape. Emergency contraception after rape is currently provided at the Hospital following a negative pregnancy test, and this practice will continue after the Combination. There are numerous drugs appropriate for emergency contraception. The attending physician may choose the best available option for each patient and will continue to do so after Combination. The physician's prescription for a contraceptive in these circumstances will be available and may be filled at the Hospital pharmacy.

Fertility procedures and counseling are not currently performed at the Hospital but are outpatient procedures performed by the University's faculty at their private medical practices. Fertility procedures and counseling will not change following the Combination. Vasectomies are not currently performed at the Hospital but are performed as outpatient procedures outside of the Hospital. This will not change following the Combination.

Planned tubal ligations following a delivery are the only procedure currently being provided at the Hospital that will not be provided at the Hospital following the Combination. Tubal ligations and other sterilization procedures unrelated to pregnancy will continue to be provided as an outpatient procedure by the University's faculty at their private medical practice or other facilities. Although there is no legal requirement that every hospital provide every conceivable health care procedure, the University has entered into an enhanced affiliation agreement with Baptist Hospital East ("Baptist Hospital") which will permit patients of the University's obstetric and gynecological faculty to be admitted, regardless of their ability to pay, for both deliveries and tubal ligations. The agreement, which makes all faculty in the University's Department of Obstetrics, Gynecology & Women's Health active medical staff of Baptist East, expands a 1991 academic affiliation agreement between the University and Baptist East and ensures the University faculty will continue to provide the community a full range of reproductive services, including tubal ligations. Transportation and procedure costs will be paid for indigent patients from a designated fund which is fully capitalized and will continue in perpetuity.

Most tubal ligations are elective, and the Hospital's experience has shown that the vast majority of tubal ligation requests are made several weeks before delivery. In any event, patients who arrive at the Hospital (or any hospital) for a delivery and ask for a tubal ligation following delivery – without providing advance notice – are not eligible for the procedure. Kentucky law requires a minimum 24-hour advance notice for tubal ligations; Medicaid patients are required to provide at least 72 hours, and up to 30 days, advance notice for tubal ligations. Further, tubal ligations are not performed on an emergency basis, e.g., secondary to an auto accident; likewise, patients in Kentucky are not allowed to give consent to convert a delivery to a Caesarean section with tubal ligation without prior informed consent, which must be done well in advance of the procedure. As a result, patients who are admitted to any hospital for delivery, including the Hospital, would not be permitted by law to undergo a previously unscheduled tubal ligation. This provides ample notice for scheduling a delivery, whether in advance or otherwise, at an

appropriate facility. Access to and quality of care for tubal ligations will not change after Combination. Instead, only the location will change.

Some opponents of the Combination have characterized the plan for providing tubal ligations post-Combination as "separate but equal." This is a fallacy. First, it ignores the fact that indigent patients already receive care primarily through facilities with a mission for indigent care like the Hospital. Second, it ignores the fact that a number of medical procedures are already performed by University physicians at a variety of hospitals. The patients of University physicians may receive care wherever their physicians have privileges, which has been and will continue to be determined through consultation between the patient and her physician. If a patient has a scheduled caesarean section with a planned tubal ligation under one anesthesia, her doctor will tell the patient that he or she practices in multiple hospitals and identify the hospital where the procedure will be performed. If a patient wants a vaginal delivery, the doctor will advise her that he or she practices in multiple hospitals where the procedure can be performed. This is routine. For example, when the University expanded the Department of Neurosurgery, patients who needed skull-based surgery were told that University faculty perform that operation at Baptist East. To have members of the faculty of a medical school practice in multiple hospitals and provide services in multiple hospitals also is routine. As a result of enhanced access to Baptist East for indigent care and an expansion of the patient base available for University obstetrical and gynecological department faculty and residents, access to care and quality of care will improve. Moreover, University residents will have the opportunity to train at Baptist East's facility with its significantly larger obstetrics patient base.

Following the Combination, the University of Louisville School of Medicine will retain complete academic freedom and autonomous control. The Network Entity's bylaws confirm that the Network Entity "believes in academic freedom and will not place any restrictions on the content, curriculum, or location of classes taught by the University at the Teaching Hospital Facilities [*i.e.*, the University of Louisville Hospital, James Graham Brown Cancer Center, Frazier Rehabilitation Institute, and Jewish Hospital]." *Id.* at 2.3.3. Importantly, Network Entity's bylaws also provide:

> It is appropriate for physicians to educate patients on all of their medical and surgical treatment options and to fully discuss with patients all of the patients' contraceptive and other medical care options, including natural family planning, medical devices (*e.g.* IUDs), pharmacologic, and surgical interventions (*e.g.* tubal ligation) in order for patients to make informed choices. [Network Entity] accepts the free, unrestricted, and mutual exchange of information between physicians and patients.

Id. at 2.3.4.

A $15 million fund will be established prior to the Combination to fund services not performed at the Hospital including, tubal ligations for indigent patients. These procedures will not be paid for with QCCT funds.

In sum, all medical procedures previously available to patients at the Hospital and previously performed or taught by University professors and medical practitioners, and previously taught to University students and residents, will remain available. The location for tubal ligations will change, but transportation to the facility at which they will be performed will be provided to indigent women.[6] All procedures will be available regardless of the religion (or lack of religion) of the students, faculty, residents, professors, medical practitioners, and patients.

B. The Combination will not violate the Establishment Clause of the First Amendment to the United States Constitution or the Kentucky Constitution

Since the date of the Consolidation Agreement and in response to concerns raised by certain governmental officials and community leaders, the parties have entered into a "Common Purpose Agreement" in order to clarify the roles of the University and its academic medical facilities after closing.

The Common Purpose Agreement makes several matters clear. Neither the Hospital, the University, nor the University's Medical School, is bound by the FBPs as a result of the Combination. UMC does not, by virtue of the Combination, become a Catholic entity bound by the Ethical Religious Directives of the Roman Catholic Church (the "ERDs"). What *does* occur as a result of the Combination is that the parties agree *by contract* not to perform tubal ligations, euthanasia, or elective abortions on the Network Entity's premises. Tubal ligations will continue to be performed, but at a different hospital. By state law, elective abortions are not currently permitted at the Hospital. Similarly, euthanasia has not been performed at the Hospital and will not be performed thereafter. Should the ERDs change in the future, CHI has no right to require that UMC abide by such changes, but will have the right to unwind the Combination (as discussed elsewhere).

The Combination does not run afoul of the constitution. First, the Establishment Clause only applies to "state action" by "state actors." Federal district courts have specifically held that UMC is not a state actor and that it does not meet any of the factors that courts examine to determine whether an entity is a state actor for constitutional purposes. Second, even if UMC were deemed to be a "state actor," the Combination does not violate the Establishment Clause because it has a secular legislative purpose, does not have the principal or primary effect of advancing or inhibiting religion, and does not foster an excessive entanglement with religion. See *Lemon v. Kurtzman,* 403 U.S. 602 (1971). The Combination will not lead to religious indoctrination that could reasonably be attributed to government; healthcare will be provided at the Hospital without regard to religion; the Combination will not create a "crucial symbolic link" between the government and religion; and the Combination will not fund a specifically religious activity, will not endorse religion, and will not entangle government with religion.

C. The "Unwind" Provisions are Fair, Affordable and Financeable

What if, despite the best intentions of all concerned, the Combination proves to be detrimental to the citizens of Kentucky or to the University of Louisville?

[6] Transportation will be provided from the patient's residence to Baptist East. As noted above, there will be no need for a "transfer" from the Hospital to Baptist East or other hospital because the delivery and tubal ligation are scheduled procedures requiring advance notice.

(1) Description of the Unwind Provisions

The provisions in the Combination documents dealing with the termination rights of the University and the transfer of the Academic Medical Center to the University are commonly referred to as the "unwind." They are found in the Academic Affiliation Agreement, the Sponsorship Agreement among the University, CHI and JHHS, the New Lease, and a letter agreement between the Commonwealth, University, CHI, JHHS and UMC (the "Letter Agreement"). In summary, an unwind can be caused (1) by the University if the Academic Affiliation Agreement is terminated (whether by breach or non-renewal) or (2) by CHI if the Ethical and Religious Directives change. If a party terminates the Academic Affiliation Agreement, the parties are obligated to work together for a period not to exceed two years in order to develop and implement a plan to transition the Academic Medical Center to the University in a reasonable manner. The Network Entity will have the right to put certain other ancillary facilities in Jefferson County to the University in certain circumstances. In addition, the lease for the Hospital will automatically terminate upon the termination of the Academic Affiliation Agreement, vesting the University and the Commonwealth with possession of the current state-owned healthcare facilities (the Hospital and the James Graham Brown Cancer Center). As discussed more fully in Section III, if a breach of the Academic Affiliation Agreement is not cured to the satisfaction of the University, dispute resolution mechanisms fail, and the University fails or refuses to exercise its rights under the Academic Affiliation Agreement, then the Commonwealth has the independent right to exercise such rights, as described in the Letter Agreement.

The unwind is structured as the acquisition of an operating healthcare center in order to maximize the University's ability to purchase the underlying healthcare assets of the Academic Medical Center. Therefore, the assets purchased will include not only all of the real and personal property located in the Academic Medical Center, but also an allocated portion of cash, marketable securities, accounts receivable, and other intangible assets necessary to operate the Academic Medical Center as an established healthcare business. The purchase price is based on the business enterprise value or going concern value of the healthcare facilities transferred (which will be determined by an independent appraiser, who will be mutually selected by the Sponsors, using nationally-recognized valuation methodologies), less any debt assumed by the University in connection with such facilities. In addition, the University will receive a credit against the purchase price equal to 16% of the business enterprise value of the Network immediately prior to the termination (which represents the amount that UMC contributed to the Network Entity). There has been concern expressed by some in the community that the unwind provisions will require the University or the Commonwealth to "buy back" Hospital assets that were initially paid for by the Commonwealth. As this analysis makes clear, this is not the case. The unwind provisions only require the University to pay for the incremental assets it receives over what UMC initially contributed to the Network Entity and do <u>not</u> require the University to "buy back" any of the assets currently owned by the Commonwealth.

If the University/Commonwealth triggers the unwind in connection with a breach by the Network Entity, CHI triggers the unwind as result of a change in the Ethical and Religious Directives, or the Network elects not to renew the Academic Affiliation Agreement, then the University has three years (in addition to the two-year transition period described above, for a total of five years) to pay the purchase price to the Network Entity. If the Commonwealth or the

University decides not to renew the Academic Affiliation Agreement, then it is required to obtain the financing by the end of the two-year transition period, which is a factor that would presumably be considered before the decision is made to not renew the Academic Affiliation Agreement.

D. The Combination will not affect prior or future Charitable Contributions

UMC dissolved its charitable foundation, the University of Louisville Hospital Foundation, Inc., on December 29, 2009. At that time, the assets of the Hospital Foundation were distributed to UMC, and none of these assets were endowed or otherwise restricted gifts. Since that time, UMC has not conducted planned giving activities. UMC sporadically receives minimal charitable donations, and no donation received since January 1, 2008 has exceeded $75,000. UMC does not have any employee who spends 25% or more of his or her time in fundraising or planned giving activities.

Pursuant to a Fundraising and Investment Agency Agreement (the "Fundraising Agreement") dated October 12, 2009 among UMC, the University of Louisville Foundation, Inc., and the University, the University, through its Office of University Advancement, directs and manages certain fund-raising campaigns and the Foundation invests the funds raised. Funds that have been raised under the Fundraising Agreement have been in furtherance of the research-related activities of University of Louisville Medical School faculty associated with the James Graham Brown Cancer Center. These funds represent gifts made to the University and/or the University of Louisville Foundation and are held on the University of Louisville Foundation's books and are not available to the Hospital or the James Graham Brown Cancer Center for clinical purposes. The University of Louisville Foundation is not a party to the Combination, and the Network Entity will not have any control over these funds.

E. Failure to Consent to the Combination Risks the Future of UMC

From UMC's perspective, the Combination is a transaction of necessity, not of convenience, if UMC is to achieve its mission. Despite being hemmed into a single downtown location without access to expansion capital and facing stiff competition for private pay patients and higher-margin procedures, UMC continues to pursue its mission of providing health care for the underserved indigent population at a high cost. Increasingly, that cost is one that is not compensated for, either through state DSH funding or through the QCCT payments. To fund this shortfall, UMC has been obliged to forego important capital improvements — improvements that would help it upgrade the current level of medical care it provides and allow it to construct facilities to accommodate additional, already approved, beds that would lead to providing care for more private-pay patients and create a sustainable bottom line.

Even a superficial look at UMC's financial situation reveals the risks of the Combination's disapproval. Last year, the Hospital and the James Graham Brown Cancer Center cared for 4,097 uninsured inpatients and 23,656 uninsured outpatients. During the last five years, indigent care costs have gone from providing $66,905,585 in statewide indigent care for the fiscal year ending June 30, 2005, at a net loss after DSH and QCCT payments of $1,172,000, to providing $89,000,944 in indigent care for the fiscal year ended June 30, 2010, at a net loss of

$20,298,016 after DSH and QCCT payments. Without the Combination, the healthcare safety net for the poor will be compromised.

UMC provides more than half of the total uninsured care provided by all hospitals in Jefferson County, Kentucky. It provides the highest degree of indigent hospital care, both in absolute numbers and in percentages of the total of uninsured patients, of all hospitals in Louisville or Lexington.

One possible solution to UMC's financial situation would be to construct additional facilities to house "private pay" beds. To determine whether this solution was feasible, UMC commissioned KaufmanHall consultants in 2008 to assess UMC's capital position and to advise whether UMC could adopt a financing strategy that would permit it to construct additional facilities to house private-pay beds and additional operating rooms (an estimated $150 million capital expenditure). KaufmanHall concluded that: (i) UMC's financial integrity could not be maintained without "a combination of operational cash flow improvements, capital deferral/reduction, and/or increased philanthropy or other sources [of funds];" (ii) UMC would be unable to "support strategic capital spending or infrastructure projects within the next few years;" (iii) UMC "has an acute need for inpatient bed capacity, especially in intensive care [and that] this reality will limit the effectiveness of the organization's strategies by constraining its ability to support growth of its patient base;" and (iv) "the level of cash flow currently generated ... is insufficient to support the magnitude of capital investment required." KaufmanHall also concluded that UMC needed a total of over $230 million in capital expenditure through its 2013 fiscal year in order to provide the patient beds, operating rooms, and other capital expenditures needed to remain competitive.

The inability to raise additional capital also subjects the Hospital to licensure and accreditation risks. Federal meaningful use guidelines require that hospitals move to electronic health record systems in the next year or face significant and escalating penalties starting in fiscal year 2015. Costs associated with these IT upgrades are significant, especially to small systems and standalone hospitals.

The cost of IT systems for JHSMH and the Hospital/James Graham Brown Cancer Center will likely increase by more than $50 million if they are forced to implement them as separate and distinct entities. The ability for any prospective partners to fund capital-related projects will markedly diminish as scarce capital dollars are directed to IT infrastructure needs as they seek to avoid financial penalties established by the federal government. This lack of capital investment will result in deteriorating facilities and equipment. The potential partners will be unable to achieve improvements in care because medical professionals do not have access to complete patient records electronically.

Absent the Combination and without the immediate capital infusion the Combination promises, UMC, which in 2008 ranked seventh in market share in the KIPDA Inpatient Market, will be marginalized even further. It will be relegated to the status of a county hospital for the indigent, lacking the finances and facilities to compete against its largest competitors. Those competitors will no doubt include not only the Norton Healthcare system but also the CHI/Jewish system, which will proceed with its local and state-wide plans, only without UMC.

And as UMC's position is compromised, so too will be the Medical School's mission compromised.

CONCLUSION

On the day after Christmas in 1976, then-Courier-Journal reporter, Keith Runyon, reported that "Louisville's General Hospital, the busy center of health care for the community's poor since 1913, is slowly dying, and the idea of a 'charity hospital' may be dying with it." *Courier-Journal,* December 26, 1976.

A number of efforts have ensued to ensure that the community's indigent population is provided with a quality of care comparable to the quality of care provided to those who can afford treatment while at the same time meeting the University of Louisville's School of Medicine's need for a teaching and research facility that will attract and retain the best and brightest medical students. These efforts continue to this day, as pressing medical needs throughout the Commonwealth must be addressed in the face of pressures on state funding and the difficulty in raising the capital necessary to maintain first-class healthcare facilities.

The Combination is Kentucky's best opportunity to confront these challenges, now and to do so head-on.